


M e m o r a n d u m

To : Mr. Ramon J. Hirsig
Executive Director – MIC: 73

Date: April 20, 2005

From : Kristine Cazadd
Chief Counsel 

Subject : Readoption of Emergency Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*

Chief Counsel Matter – April 27, 2005

I request your approval to submit the attached Readoption of Cigarette and Tobacco Products Tax Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, to the State Board of Equalization at the April 27, 2005 meeting to be readopted on an emergency basis.

Background

Senate Bill (SB) 1701, enacted in 2002, added a new section 30162 to the Revenue and Taxation Code. This new statute requires the Board to replace authorized cigarette tax stamps currently in use (i.e., heat-applied decal tax stamps), with a tax stamp that can be read by a scanning or similar device and encrypted with specific information.

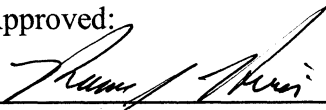
The Board has begun selling the new tax stamp to licensed distributors. However, the sale of new tax stamps must be implemented over an extended period of time, as distributors are in the process of acquiring the appropriate machinery.

Section 30162 does not specifically provide for a transition to the use of the new tax stamp. However, in Section 6 of Statutes 2004, Chapter 822, the Legislature declared that the Board has the authority to implement the changes required by SB 1701 by regulation so that commerce in the state is not negatively impacted. Effective January 1, 2005, Regulation 4056.1 provided for the use of the heat-applied decal tax stamp until April 30, 2005. However, it has been determined that additional time is needed to afford distributors an orderly transition to the new stamp.

The proposed readoption of Regulation 4056.1 will enable distributors to utilize the current

heat-applied decal tax stamp during their transition to the use of the new tax stamp until May 31, 2005. The proposed readoption of Regulation 4056.1 is ready for submittal to the Board under the April 27, 2005, Chief Counsel Matters.

Approved:



Ramon J. Hirsig, Executive Director

Regulation 4056.1 Expiration of Heat-Applied Decal Tax Stamps

On and after January 1, 2005, the Board authorizes the continued application of heat-applied decal tax stamps through May 31, 2005 in order to effect the orderly transition from heat-applied decal tax stamps to the new tax stamps required by Revenue and Taxation Code Section 30162, subdivision (a), effective January 1, 2005. Operative June 1, 2005, the Board will no longer sell, or allow for the application of, any cigarette tax stamp other than tax stamps which utilize technology meeting the requirements of Revenue and Taxation Code Section 30162, subdivision (a), effective January 1, 2005.

Note: Authority: Sections 30162 and 30451, Revenue and Taxation Code.

Reference: Sections 30161 and 30162, Revenue and Taxation Code; Section 6 of Statutes 2004, Chapter 822.

FINDING OF EMERGENCY

The State Board of Equalization (Board) finds that the readoption of Cigarette and Tobacco Products Tax Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, is necessary for the immediate preservation of the public peace, health and safety, and the general welfare and meets the standards set forth in Government Code Section 11349.1.

The readoption of this regulation is necessary on an emergency basis to avoid any interference with commerce related to the sale of cigarettes within this state on and after the April 30, 2005 expiration date of current Regulation 4056.1. Without the proposed readoption, cigarette distributors will be unable to sell cigarettes, resulting in the loss of income to distributors. Further, if distributors cannot sell cigarettes, there will be a reduction in revenues for the General Fund, Cigarette and Tobacco Products Surtax Fund, and the California Children and Families Trust Fund.

STATEMENT OF SPECIFIC FACTS SHOWING THE NEED FOR IMMEDIATE ACTION

Under the Cigarette and Tobacco Products Tax Law, the Board collects the cigarette excise tax through the sale of tax stamps or meter impressions (hereafter collectively referred to as "tax stamp") to licensed distributors (Rev. & Tax. Code § 30161). All packages of cigarettes sold in this state must bear a tax stamp (Rev. & Tax. Code § 30163). Revenue and Taxation Code section 30162 provides that stamps for affixation to cigarette packages shall be of the designs, specifications, and denominations as prescribed by the Board. The Board prescribes by regulation the method and manner in which tax stamps are to be affixed to packages of cigarettes. The Board may likewise provide by regulation for the cancellation of stamps (Rev. & Tax. Code § 30162). Currently, the tax stamps that the Board sells are heat-applied decal tax stamps.

Senate Bill (SB) 1701, enacted in 2002, added a new Section 30162, effective January 1, 2005. This new statute requires that the Board generate tax stamps by a technology capable of being read by a scanning or similar device and that tax stamps must be encrypted with, at a minimum, the following information: (1) the name and address of the distributor affixing the stamp to the cigarette packages, (2) the date the stamp was affixed, and (3) the denominated value of the stamp.

The Board has begun selling the new tax stamps to licensed distributors in accordance with subdivision (a) of new section 30162. However, the implementation of the new cigarette tax stamps requires distributors to purchase new stamp application machinery. In response to SB 1701 (2002), the Board, in conjunction with the Department of General Services, sought bids for the new tax stamp technology. Due to the resulting time frame for the awarding of the contract and a subsequent protest by one of the bidding parties, the new stamp application machinery was not available to all distributors for conversion to the new tax stamp technology by January 1, 2005. As such, many distributors were not in a position to affix the new tax stamps by the January 1, 2005 effective date.

The provisions of Section 30162(a) do not specifically provide for a transition to the use of the new tax stamp. However, in Section 6 of Statutes 2004, Chapter 822, the Legislature declared that the Board has the authority to implement the changes required by SB 1701 (2002) by regulation so that commerce in the state is not negatively impacted. Based on this authority, the Board adopted emergency Regulation 4056.1, effective January 1, 2005. The regulation will

expire on April 30, 2005. The Board has determined that an additional 30 days is required to ensure that all distributors have the new stamp application machinery and that the machinery is working at required levels.

Unless the proposed regulation enabling distributors to utilize the current heat-applied decal tax stamp beyond January 1, 2005, is readopted, distributors without the new stamp application machinery working at required levels, will be unable to sell any cigarettes, resulting in the loss of income to those distributors. Further, if distributors cannot sell cigarettes, there will be a reduction in revenues for the General Fund (including breast cancer research), the Cigarette and Tobacco Products Surtax Fund (for hospital services, health education, physician services, research and public resources), and the California Children and Families Trust Fund (for early childhood development). In fiscal year 2002-2003 alone, for example, the Board collected approximately one billion dollars in cigarette tax revenue which was deposited directly into these funds. Accordingly, the proposed regulation allows all distributors to continue selling cigarettes, maintaining their income and maintaining state revenues.

AUTHORITY AND REFERENCE CITATIONS

Authority: Section 30451, Revenue and Taxation Code.

Reference: Section 30162, Revenue and Taxation Code; Section 6 of Statutes 2004, Chapter 822.

INFORMATIVE DIGEST

Under the Cigarette and Tobacco Products Tax Law, the Board collects the cigarette excise tax through the sale of tax stamps to licensed distributors. All packages of cigarettes sold in this state must bear a tax stamp. Revenue and Taxation Code section 30162 provides that stamps for affixation to cigarette packages shall be of the designs, specifications, and denominations as prescribed by the Board. The Board prescribes by regulation the method and manner in which tax stamps are to be affixed to packages of cigarettes. The Board may likewise provide by regulation for the cancellation of stamps. Currently, the Board sells heat-applied decal tax stamps.

Senate Bill (SB) 1701, enacted in 2002, added a new Section 30162, effective January 1, 2005. This new statute requires that the Board generate tax stamps by a technology capable of being read by a scanning or similar device and that tax stamps must be encrypted with, at a minimum, the following information: (1) the name and address of the distributor affixing the stamp to cigarette packages, (2) the date the stamp was affixed, and (3) the denominated value of the stamp.

Regulation 4056.1, *Expiration of Heat-Applied Decal Tax Stamps*, is proposed to implement a transition period from the heat-applied decal stamp to the new tax stamp required by Revenue and Taxation Code section 30162, enacted by SB 1701 (Stats. 2002, Ch. 881). Specifically, the regulation will provide for the use of both the heat-applied decal stamp and the stamp specified in Revenue and Taxation Code section 30162(a), effective January 1, 2005, through May 31, 2005.

The regulation provides a transition to the sole use of the new tax stamp, thereby avoiding any disruption to the stream of commerce affecting cigarette distributorship operations and state revenues.

COST TO LOCAL AGENCIES AND SCHOOL DISTRICTS

The State Board of Equalization has determined that the proposed rule does not impose a mandate on local agencies or school districts.

ESTIMATE OF COST OR SAVINGS

The State Board of Equalization has determined that the proposed regulation will not result in any direct or indirect costs or savings to any state agency; any cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of Title 2 of the Government Code; any other nondiscretionary costs or savings imposed on local agencies or school districts; or, any cost or savings in federal funding to the state.